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JBS S.A.'s (JBSAF) CEO Wesley Batista on Q2 2016 Results - Earnings Call Transcript

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JBS S.A. (OTC:JBSAF) Q2 2016 Earnings Conference Call August 11, 2016 10:00 AM ET

Executives

Wesley Batista – Global President, Chief Executive Officer

André Nogueira – Chief Executive Officer, JBS USA

Russ Colaco – Global Chief Financial Officer

Jerry O'Callaghan – Investor Relations Officer

Analysts

Farha Aslam – Stephens Inc.

Viccenzo Paternostro – Credit Suisse

Lauren Torres – UBS

Alexander Robarts – Citibank

Jose Yordan – Deutsche Bank

Kerry Callahan – SunTrust

Bryan Hunt – Wells Fargo Securities

Operator

Good morning, everyone, and welcome to JBS Conference Call. During this call, we will present and analyze the Results for the Second Quarter of 2016.

Now, I'll turn the conference over to Mr. Jerry O'Callaghan, Investor Relations Officer.

Jerry O'Callaghan

Hello. Good morning, everybody and welcome to our second quarter 2016 earnings call. With us here today, we've got the Global President of our company, Wesley Batista, we've also got from the U.S. André Nogueira, who is the CEO of our U.S. Operations, Enéas Pestana who is the President of our operations in South America. With us also is Mr. Gilberto Tomazoni, who is the President of Global Operation; Mr. Tarek Farahat who is our Global President for Marketing; and also with us today is Russ Colaco who is our new Global CFO.

Before passing you onto our CEO, I would just like to briefly read the disclaimer in our presentation which is available on our website and which we will make reference too as we go through this call today. So just to read through this disclaimer this morning, on the 5th of August this year, we filed a registration statement on forms F1 and F4 with the SEC, and we also filed a request to register as a foreign issuer allied with BFR program with the CVM in Brazil.

Please refer to those documents for more information regarding the proposed corporate reorganization. During the course of this call, we will make forward looking statements. All statement that address expectations or projections about the future are forward looking statements, although they reflect our current expectations, these statements are not guarantees of future performance, but involved a number of risks and assumptions. We urge you to review JBS filings with the CVM and the SEC for a discussion of some of the factors that could cause actual results to differ materially.

During this call, we will also refer to certain non-IFRS financial measures. These non-IFRS financial measures do not have any standardized meaning under IFRS and may not be comparable with other non-U.S. GAAP or other non-IFRS financial measures publicly available.

With that I will pass you onto Mr. Batista.

Wesley Batista

Thank you, Jerry. Thank you for joining us on today's call. Last night we reported our financial results for the second quarter of 2016. EBITDA was R$2.9 billion, which was an improvement over the first quarter of this year, but below the year ago period. Net income was R$1.5 billion.

JBS is facing different opportunities and challenges in each of the regions where we operate. Our results reinforce the importance of our strategy to diversify our business

operate. Our

across both markets and segments. I would like to provide you some of my perspective on

the key highlights through the quarter. First, last week we filed our F-1 with the SEC and launched our consent solicitation for the bondholders in connection with our reorganization. We remain on track to compete the process by the end of this year.

In the U.S. our – this business has seen improved profitability. We expect the increase of cattle availability in the U.S. and improving domestic demand will drive further improvements and profitability. Also the export market is picking up for our U.S. business. We are very positive what this business is going to deliver to JBS in this second half of this year and going forward into 2017.

To talk about our pork business in the U.S. we had another good quarter and our team has been active and pretty good progress when we announced the Cargill acquisition, we announced that we were going to be looking for $150 million in synergies and we are well on track to get toward these synergies and may beyond to the number that we initially projected.

We are seeing pretty good pick-up in export in pork exports especially exports, pork exports to China, as we know China reduced substantially their herd, their sow herd size last year. The reduction in China was in a magnitude that is equal to all U.S. sow herd size. So we expect to keep seeing pretty good demand for pork in China. So we are very positive also what our pork business is going to deliver in terms of results in the second part of the year and going forward.

Our chicken business in U.S. and Mexico Pilgrim's Pride already reported their second quarter. I'm not going to go through Pilgrim's [indiscernible] already provided our perspective of the business.

So moving to South America and especially talking about Brazil, our Seara business was negatively impacted by the increasing especially in corn price for you all to have idea corn price is almost double the price this year comparing to last year, a pretty big increase in corn price and for sure impacted our results in Seara.

Only the impact in corn represented in the second quarter 600 basis points in margin EBITDA. We are on top of that, on top of corn, we all are seeing the real strengthening against to the dollar. Also this helps pretty big impact in our export revenues. We are very focused to pass price increase in the domestic market and as well in the export market to offset the increase in corn price in Brazil and as well to compensate and to mitigate the strengthening in the real.

This has a lag in terms of timing, but we are confident that the industry and we are going to be able to offset this through price increase in both domestic and export. We keep investing in our brands here in Brazil and especially in the Seara brand. We keep growing our customer base. We keep improving our service level and as well we keep growing in our prepared food business in value-add – growing our value-added portfolio.

We are seeing the industry in Brazil, chicken and the pork industry in Brazil reducing production and more so and these last two months and we think this is going to accelerate the amount of reduction, the amount of product that's going to be available in the domestic market, as well in the export market, and this we believe is going to be helpful to put prices, where price needs to be to put margin back where margin was last year.

So moving to beef business in Brazil, quite the same, not so impacted by grain price or corn price, but impacted in the strengthening of the real. The same opportunities we have is in the export market to put prices back where price was before the real got so weak last year. So, we see this again is a timing issue in terms of putting prices back where the price was before. But we don't see any reason that we and the industry is not going to be able to put margins back, where margin was before.

So, moving to Europe Moy Park, you all know we acquired Moy Park last year. We are very satisfied where we are and the team is very focused and on track to capture the synergies that we announced when we acquired Moy Park and we are already seeing improvement in our margins, and we are comfortable that we are going to be able to capture all the synergies that we anticipate when we acquired Moy Park.

So, a mention about Australia, you know Australia is facing a challenge in terms of cattle availability. The industry is running much less volume compared – this year comparing to last year cattle price went up substantially in Australia. So, it's a challenge for Australia, but on the other hand, is pretty good opportunity for the U.S. beef industry and as well for our beef business in North America, U.S. and Canada. So we are seeing export growing quite a lot in Japan and South Korea in some key markets that is the main players is Australia and U.S. and this is going to be positive for U.S.

Our Primo business in Australia is going well. We are satisfied where we are even though we keep looking for more opportunity to expand our margin there and as well grow our volume. In our Primo business especially, we see a pretty big opportunity to grow our Primo brand and our business outside of Australia in some key markets like South Korea, Japan and China.

So, overall, when we see other segments other regions that we operate, we – I'd like to mention again the importance of our strategy to diversify our business across various markets and segment that is playing an important role for our company.

So, now I'm going to turn to Jerry O'Callaghan to go through the numbers and go through each segment and we are going to be here for the Q&A. Thank you all. Jerry, please.

Jerry O'Callaghan

Thank you Wesley and thank you all. So I'm going to go through our presentation here make reference to the page numbers for those of you that are accompanying our presentation on the webcast.

On Page 6 of our presentation, we look at consolidated highlights for the second quarter. Net sales went from R$38.9 billion to R$43.7 billion in the period, up 12.3% second quarter 2015 against second quarter 2016. Gross profit in the comparable periods went from R$5.87 billion to R$5.27 billion, a decrease of 10.3% and gross profit margin declined from 15.1% to 12.1%.

Moving on to the next page, Page 7 in our consolidated highlights, EBITDA and net income, our EBITDA for the period, the second quarter 2016 was R$2.9 billion, a reduction of 19% in relation to the same quarter last year, which was R$2.57 billion. EBITDA margin declined from 9.2% to 6.6%. Net income, went from R$80 million to R$1.54 million in the comparable period from R$0.03 earnings per share to R$0.05 earnings per share in the period.

With regard to operational cash flow, we had a negative operational cash flow of R$558 million in the period compared with a positive operational cash flow of R$2.97 billion in the same quarter last year. Free cash flow also was negative R$1.585 billion against positive R$902 million in 2015.

Continuing on our next slide, speaking of our net debt, that increased marginally from R$48.7 billion to R$49.17 billion and leverage went from 3.84 times to 4.1 times. Just as a reminder, in this second quarter of 2016, we paid out dividends to the shareholders of JBS SA corresponding to our net income in 2016, 25% of net income which represented R$1.1 billion. We also paid a special dividend at Pilgrim's Pride which was paid out in the second quarter, and of that special dividend R$570 million went to the minorities, and we also had one-off expense in the quarter related to the unwinding of our derivatives position of $2.65 billion

billion.

Our debt profile on the next page, Page 10 in our presentation, 91% of our debt today is in U.S. dollar is 9% in Brazilian real. It's a breakdown by sources basically the same as in previous quarter. Just on the 60% with commercial banks and just over 40% in the debt capital market.

By company, almost half of our debt is at SA in Brazil and another 43% is at JBS USA and the balance at JBS Foods.

In terms of short-term and long-term debt, a slight decrease in the percentage of our short-term debt from 33% to 32% when comparing with the previous quarter, and in terms of the breakdown of the short-term debt, seeing as we are very relevant exporters out of Brazil particularly, which is a lot of the trade finance lines which are available in Brazil, so more than 80% of short-term debt in Brazil is associated with these trade-finance lines, which are rolling lines, and that we renew all the time, which are short-term by nature.

Moving on now to the business units and starting with Seara in Brazil, we previously named this JBS Foods Brazil in order to avoid any confusion with regard to the name JBS Foods, we've renamed it Seara. In the second quarter of 2016, Seara had revenues of R$4.6 billion that was up 3.3% when compared with the same period last year, R$4.6 billion in the second quarter 2015.

EBITDA declined from R$789 million to R$382 million, a decline of more than 51% and EBITDA margin went from 17.7% to 8.3%. We had a growth in revenue due to the increase in sales prices in the domestic market, as Wesley mentioned in the proceeding comments, we had a very relevant increase in corn cost in Brazil. Corn prices were practically double year-on-year in Brazil and that caused a compression of our EBITDA margin and about 6 percentage points when compared with those periods.

Further price increases will be necessary to offset the increase in the cost that occurs throughout the last year. We've had relevant improvement in our service level and we have reached, the number of active customers has reached 139,000 active customers at Seara.

At JBS Mercosul, the next slide in our presentation. This is our beef business in South America. It's primarily Brazil, but it also includes Uruguay, Paraguay and Argentina, and also our hides processing business. We had revenues of R$7.2 billion in the quarter, stable in relation to the same quarter last year. EBITDA increased from R$376 million to R$457 million, up 21%.

EBITDA margin went from 5.2% in 2Q 2015 to 6.3% in 2Q 2016. We had an increase in volume sold into the international markets, just bear in mind for instance Brazil got approved for exports to China in June of last year, so we had a full quarter of exports to China this year, which we did not have in the previous quarter

We've had a pass through of prices in domestic market, and a reduction in the volume sold in Brazil in the domestic market in Brazil. An increase in cattle prices and the appreciation of the Brazilian real in relation to the first quarter in 2016 caused EBITDA to decline quarter-on-quarter. And very recently we had the announcements of the opening of the U.S. market for Fresh Brazilian beef, and that obviously is interesting for JBS. We have relevant presence in both these markets and capabilities to distribute that product down into the market in the U.S.

With regard to our businesses outside of South America, starting with our beef business in JBS USA Beef as we call it, that includes our Canadian and our Australian business, and here we speak in dollars and not anymore in real. Our revenues declined 12.2% in the comparable periods from R$5 94 billion in the second quarter 2015, R$5 2 billion in the second quarter of 2016.

EBITDA margin also declined from 3.8%, 0.5% from $228 million in EBITDA to $27 million in EBITDA. We had an underperformance of our regional units in the U.S. basically where we source cattle from the dairy herd in the smaller regional facilities we have in North America. We had a higher production cost related to the initiation of – or the re-initiation of our Hyrum, Utah plan where we made relevant investments to expand that plant with major distribution capabilities across the West Coast of the U.S. out of Hyrum. We restarted that plan recently and we've had expenses associated with restarting of the plant.

We've seen a reduction in cattle prices in the U.S. particularly towards the end of the first half of the year and that indicates a much better dynamic for the second half of 2016 As Wesley mentioned, cattle prices in Australia remained elevated due to strong cow and heifer retention which has contributed to compressed margins there Important to remember that the climate in Australia has improved quite a lot, we've seen good pasture which is a good indication going forward, and this is a reason why we are seeing so much cow and heifer retention in Australia which is causing the short-term increase in cattle prices

Our pork business in North America, JBS USA Pork, Page15 in our presentation, relevant increase in revenue here from $795 million in the second quarter of 2015 to $1 364 billion in the second quarter of 2016 at 71.6% increase in net revenue associated with the incorporation of the Cargill Pork assets late last year EBITDA margin and EBITDA also increased EBITDA went from $65 million in the quarter last year to $137 million in the quarter this year, but EBITDA margin going from 8 1% to 10%

Wesley also mentioned capturing of synergies associated with that acquisition. We targeted $150 million and we've already captured in excess of $80 million. We see strong demand for pork products in international markets particularly China and Asia. And we were also increasing our capacity, our capabilities in bacon production and consumer ready products and improved results from that portion of the business.

JBS USA Chicken which is our Pilgrim's Pride business which already reported so not much new to add here Revenue was year on year, just over $2 billion EBITDA declined higher, $426 million in the second quarter of last year to $283 million in the second quarter of this year with EBITDA margin declining from 20 7% to 13 9% We had a reduction here in volumes in this business as a result of the implementation of – operational improvement in one of our prepared and convenience facilities in the U S

There was also a reduction in Chinked prices compared with the same period last year, and we had a much better performance in our Mexican operations due to lower Chicken availability and higher sales prices in that market.

Finally, before we open up for Q&A, a quick word about our business in Europe. Moy Park which we acquired second half of last year, we had revenue here in pound sterling, revenue of £365 million for the quarter, up 1.2% from £360 million in the same quarter last year EBITDA went from £31 2 million to £ 33 5 million, up 7 3% and EBITDA margin went from 8.7% to 9.2%.

We had an increase in volumes of fresh chicken sold in the domestic market and of prepared products in the export market. And also, as mentioned earlier, we improved operational efficiencies and a better product mix, and we see continuous progress in the operational results with increased sales growth in that business.

That terminates our prepared remarks. We would now like to open up for Q&A. Thank you very much Thank you all

Question-and-Answer Session

Question a

Operator

[Operator Instructions] Our first question comes from Farha Aslam, Stephens Inc.

Farha Aslam

My first question is regarding the launch of your bonds to S1A and in terms of timing of the potential U.S. for sync, do we have any clarity around when that could happen?

Russ Colaco

Sure Farha, its Russ here. So we launched our consent solicitation. We expect that to wrap up early next week. In the F-1 if you do look, we do refer to an expectation that we would be trading in the U.S. late in the fourth quarter.

Farha Aslam

That's helpful. And then just as a follow-on to the cattle market, I think Wesley you highlighted increased cattle supplies in the U.S. Could you kind of share with us your thoughts on the increase in cattle, the pace of the increase and how JBS, which is U.S. beef margins, or kind of that division, what's normalized and where can we expect that to go over the next few years.

Wesley Batista

Well I'm going to answer. Part of your question, I'm going to ask André to add on my question. So, we have been talking about you know U.S. cycle in the beef business. We thought that the cycle was going to come – improve, the better cycle was going to come earlier, but we are very positive now that second half, we are going to see this positive cycle, showing in the result and showing in our results. I expect to see in the second half of this year margins coming back to normalized levels that we think is around 4% to 5% margin EBITDA or EBITDA margins. So, this is the level, we may tend to see quarters better than this level, but overall in average, I do see margin coming in this levels.

So, about cattle availability, André, if you can answer this part.

André Nogueira

Thanks Farha. We are seeing year-to-date Farha around 3%. We expect for the second part of the year that will be around that maybe, a little bit more, maybe 3% to 4% in terms of heads that we're going to process, but probably a little bit less weight. I think that we're going to see now the cattle compare the same period of last year, a lighter cattle that we

saw maybe even 20 pounds lighter than last year, and probably next year 2% or 3%, and another 2% for 2018. So we are just starting the cycle, the positive cycle of cattle

availability in the West. We're seeing much less production in Australia, so that's why the export had been so strong especially in the last two months. It's more cattle availability in the U.S. U.S. beef became more competitive on a global base, and the rest will recover and will grow export. So because of more export and less import, I don't think that is more cattle available will translate in a much higher from mass availability. I think then the mass available deals grew a lot in the last six month especially. I think that recover that market that was very compressed before. I expect for the remainder of this year and for next year, the net availability to be around 1% in U.S. So, helped growth and helped recover, but most of the balance will be more export and less import.

Wesley Batista

Only to add a little bit more on that. You know we are very positive for, in our beef business second half of this year and going forward 2017 is a combination, more cattle available, less imported products especially from Australia and as the cattle price in Australia went up quite a lot, so U.S. is much more competitive in Japan and South and Korea. So the combination of export, more cattle availability, you know declining cattle price all these things and we are already seeing this translating in results.

Farha Aslam

That's very helpful. Thank you.

Wesley Batista

Thank you, Farha.

Operator

The next question comes from Viccenzo Paternostro, Credit Suisse.

Viccenzo Paternostro

Hi Wesley, Hi Jerry. Most of my questions on the JBS operations were answered in the Portuguese conference call. I will focus my questions on the financial line. My first question is on the expectation for the reduction in cost of tax going forward after the corporate restructuring. It seems that it's possible to have much lower interest rates, after I mean I would say in 2018, I don't know if you have any estimate on what would be a fair assumption for the cost of that in 2018, for instance for the new companies at least in the U.S. as opposed you could have access at a much lower debt, cost of debt in the U.S. So,

that is my first question.

My second question is on the hedging. You reduced a lot of your hedging exposure from R$33 billion to R$0.5 billion only in the hedge. I'd like to know your thoughts on what would be the hedging, the size of the hedge restructuring going forward?

Russ Colaco

It's Russ here. I'll tap over the first question on the cost of debt. While we expect debt will be included in this developed market, high yield indices, and we will start to have a trading range in line with U.S. listed peers and rates in line with U.S. peers, it's very hard to predict what those will be in 2018. You might look at what other high yield companies that are similarly rated in the U.S. have in terms of yield and that might be an appropriate expectation, but hard for us to forecast that far out.

Wes, if you want to talk about the hedging policy on a…

Wesley Batista

Basically the hedging position and policy look, actually we don't have any hedge to-date in Brazil. This position that you mentioned is not any hedge in Brazil or hedging the real against to the dollar. This position is just in the U.S., a little bit in grain that was price held a little position in grain. So, our position today, we are completely un-hedged. We don't have any hedge. And you know we – you all know we have last year, we were fully hedged as we thought that the real was going to depreciate and we put 100% hedge against our exposure.

And in the beginning of this year from January to April, we took all the hedge out because we – the scenario changed completely, and we think that the real does not make sense to put any hedge on the real to-day, due two fact; one is the cost of this hedge does not make sense and the perspective in Brazil is getter better every day in terms of the political situation here, the economy and the you know the fiscal debt, all these things. So it does not make sense in our view to put hedge. So this is one thing.

The other thing is that, as we complete our reorganization and you know reporting our earnings in JBS Foods International and being now reported in dollars, this is going to take our necessity to being placing hedge against the real, so we don't have any plans to put any hedge in place now or going forward in the scenario that we are seeing in the market place.

Viccenzo Paternostro

Perfect. Thank you very much.

Wesley Batista

Thank you.

Operator

The next question comes from Lauren Torres, UBS.

Lauren Torres

Hi good morning everyone. My question is on pricing at Seara. You mentioned that the corn price hike was too big I guess offset with pricing so far and that there is room for further pricing. So, curious what should be your perspective on what type of pricing we should see? I know there has been a strong margin story, so just curious how you are thinking about, I don't know if it's the second half story or we should start give our next year as far as we're covering some margins, and if that's price-led and by how much pricing you have to take yet there?

Wesley Batista

Lauren, basically this is going to be a moving progress, so we are going to see the price in the domestic market as well as in the export market recovering, during this second half of this year, and hopefully, we can get all the price recover by year. And we can see 2017 stable price dynamics and margin back to where margin was before. As we are low, when you think about, we have two major and very relevant impacts in our Seara business. One was corn. You know today's worth doubled the price comparing two year ago. That is a Brazil issue and we think that it's going to improve going forward as Brazil is importing more corn and as well we are going to get and in the new cycle to be able to see more corn available. And as usual when you have corn in the price that it is now in Brazil, this stimulate a lot to increase the size of the, the planting area, so we think that we are going to have a better scenario in the grain, in the corn market for next year.

And in the export business, the biggest – on top of the domestic market, but in the export market is the largest opportunity in terms of translating price increase into results. And why, last year as the real went to 4 by the end of last year, you know everybody increased a lot export and put much more product in the export market, for you to have idea, Brazil was exporting 300,000 tons per month and went to 400,000 tons per month, because it got very attractive with the real at 4. And the velocity and the magnitude that the real appreciated, so – was much faster than the industry was able to put price back what price

was before the real got so weak last year. But this is a question of time. We don't have any double that we are going to see prices back, where price was before when the real was at 3 last year, but it's a lag.

The corn and the real, you know the real appreciate and the corn went higher, very, very fast. And price is going to catch up. My view, we think we are going to end up 2016 without the price recover implemented.

Lauren Torres

That's good to hear. And if I could ask one unrelated question, the U.S. for Brazilian beef, I guess this is becoming now more of a reality. So just curious to get your perspective on what this could translate into for you as far as incremental and maybe the opening of other markets? How are you thinking about the benefit of this flow through, once it does occur?

Wesley Batista

Look this is mid-term and also short-term. Mid and long-term is very, very positive for the Brazilian beef business. Not only to be able to access the West beef market, but also you know to foresee future expansion in terms of market opening, to Brazil, once the markets openings, so Brazil, I think this is the first step for Brazil being able to foresee another market, important market opening to the Brazilian beef industry. And think about, we are the company that has the best structure in the U.S. to be able, you know to distribute and to sell Brazilian beef products in the U.S. market. So, we have knowledge, we have very sizable operation. We know the customer, their distribution, we have sales team. So we are very positive in terms of what it's going to bring to the Brazilian beef business. And in the other end, it's not going to jeopardize in any regard in our view the U.S. beef business given the fact that Australia, the amount of production in Australia is well below last year and Australia is shipping much, much less product to the U.S.

Lauren Torres

Good to hear. Thanks again.

Wesley Batista

Thank you.

Operator

The next question comes from Alexander Robarts, Citigroup.

Alexander Robarts

Hi everybody. Thanks for taking my question. I guess, the first question relates to the JBS Pork business. I thought it was interesting how you laid out the scenario going forward for exports in the Portuguese call earlier from the U.S. of pork, and I want to understand the opportunity. I guess sow herd reduction in China is now coming to the point where they just need to import a lot of pork. How does that translate as far as the JBS Pork business thinking of the second half? I understand 15% to 20% of the industry is exported. Is this an opportunity that could really be an outsized opportunity in the sense that we should expect a lot more of your product to be exported, and of the industry, then as the second biggest player in pork, do you think double digit margins then in the pork business become feasible for the second half? And are you considering about any kind of supply issues go in the U.S. So kind of a sell pieces of the questions, but around this whole idea of the Chinese sow herd reduction and your export possibilities?

Wesley Batista

Alex, I'm going to ask André to answer your question. Please André.

André Nogueira

U.S. this year, exports grew to Chinese close to 300% compared to last year, that's due to the size of the pork tonnage. And by answering a few, there is more production in pork, that's the normal business now as of September for more production that U.S. pork needs will become even more competitive. So, if you look at the last year or so, and including the first part of this year, U.S. Pork, this was more expensive than European meat. So that was for the export, but U.S. internal consumption was so good in the first quarter of the year that we could deliver good margin and good performance despite of export obviously so strong.

Now we're entering the second part of the year, and for next year, at U.S. it will be cheaper and maybe much cheaper than Europe. So, I expect a very strong growth, whose reasons to growth of July is China, and I don't think that will be only China. I think that U.S. is the point of competitive in price of export to grow beyond China.

Wesley Batista

So Alex, just to add a portion, so you ask about margin double digit level, margin, you know we definitely think that is doable and is going to be in our view the case given the

fact that we see pretty big opportunity for pork exports and also pretty good hog availability in the market. So we are seeing, we saw a pretty big decline in hog price, and like André mentioned today, U.S. is so competitive in terms of cost and price, that we believe not only in China, U.S. is going to get pretty good traction in other markets in terms of export. So the combination of these things on top of that you know, we believe we have a very, very, well running pork units and pork business and we are in very, very good position to take advantage of that.

André Nogueira

And well, the other point that in the first part, the synergy that the plan worked after the synergies, so we are having big improvement in the operation the sales side of the business that we acquired. So that's on top of the March condition, I think our performance will continue to drive high margins.

Alexander Robarts

Fair enough. That's clear and thanks for that. The second question relates to one of the things I have marked on in the documents that we kind of were able to see for the first time related to the SEC registration and filing. There is a piece here that talk about related party transaction. And I guess what was interesting to see is that, when you look at the cattle purchase agreement that JBS has answered, I guess a millions heads, right, at minimum that you have to buy even Oklahoma or Australia or Canada, but the bulk of that is in Oklahoma. How are you thinking about these cattle purchase agreements going forward? Is this something that you feel is a competitive advantage versus other players in the industry? I mean one of the things we've seen in the sharp drop, right where you certainly have the cattle prices as we've had these mark-to-market issues that have kind of been impactful on your margins recently, and I'm wondering does it make sense to reduce or those cattle purchase agreements or amended them or do you feel comfortable with them, and just kind of maybe giving us a little perspective on these millions heads a year that you contract to buy through your businesses. Thanks very much.

Wesley Batista

Thank you. André please.

André Nogueira

This is a big advantage for JBS to have this. It was a big advantage and we all, just time of low cattle supplier and continues to be the big advantage for JBS. We're going to have this captive supply. We'll buy at market price, so there is no benefit or negative impact in terms

of pricing for JBS. It's just a capture supply. This is in favor of JBS. As JBS decides to buy any last cattle, I think that for the other size is more than half to reduce that. But this is beneficial for JBS to have this captured supply of cattle. So, there is not negative, we but this at nice price, this was a capture supply and we work to develop specific program that it's just possible to also have this relationship. We have been the largest metro supplier of beef in U.S. and we have that because of this captured supply.

Alexander Robarts

Got it. Okay. Thank you.

Operator

The next question comes from Jose Yordan, Deutsche Bank.

Jose Yordan

Good morning everyone. Just a clarification on these regional units and what percentage of the total U.S. business they represent? And if you can give us any color about how much money and pre-operating expense are we talking about in terms of negative impact in the quarter. I mean I guess what I'm getting to is, why would the second quarter margin in JBS USA Beef, what would it have been had it not been for these two one-offs that we're talking about here in the press release and the presentation.

Jerry O'Callaghan

Hello. We got cut off for a minute. I think we're back on line. Are we?

André Nogueira

Well if you want, I can answer the question.

Wesley Batista

Go ahead André. We're going to start off here with… Go ahead.

André Nogueira

So, Jose, the size of the business, unless you have four plants that you call the fed business, and have five plants that are smaller plant and regional plant that we call the regional business. In terms of size, the regional business, in terms of sales is half of the sales of the fed business. Other plants are smaller plants and in this plant we process most Holsteins and dairy cows and beef cows. So, this has been a good business overall

for us. The have this [indiscernible] of course now that we saw this retention of cow that we have in U.S., we're processing less cows in that. The profitability of this business at this moment was in the second quarter more than the fed business.

So of course the fed business was the total business now. More important than that in terms of impact in the quarter was Canada. I explained just in the first quarter, Canada we have one plant and we process the other. In Canada we have a lot of contracts and rent here was very short in U.S. with discount that we normally have in cattle in Canada, we buy cattle $150 per head lower in Canada than we buy in U.S. that discount is up here and that's really impact the result of that business and first quarter and the second quarter that was probably in terms of total month, the biggest impact for us in the quarter.

This is not the case anymore. The start starts you are seeing May, especially in June and now in July, the cattle price in Canada went back to the normal discount level for the U.S. and that's probably will be trend with more cattle available in the U.S. to go back to the normal trend. And you have the higher open of the new fab floor and the new distribution that impact our business. As we have already comment, we expect, without these one-offs in the more normal in the regional business that we're going to see in the second part of this and the next year the beef business going back for quarter. You can have a quarter that will be above that, but the normal level between 4% and 5%.

Jose Yordan

Okay. Thanks for the color.

Operator

The next question comes from Kerry Callahan [ph], SunTrust.

Q –Kerry Callahan

Two questions if I could. First on the Seara business, I don't want to put words into Wesley's moth, but I think I heard him say the 600 basis points adverse impact of the corn could be recovered by late in 2017, looking at the historical EBITDA margin was more like 17% to 20%. Do you think you get back there in 2018?

Hello? Can you hear me?

Jerry O'Callaghan

We got cut off briefly here. I'm sorry we had some issue in Sao Paulo. We got cut off. We're just reconnecting now actually on cellphone. But we can hear you well. So, if you can take it from here if you don't mind.

Gerry Callahan

The question on Seara was, you might recover the 600 basis points from the corn adverse impact by the end of 2017, but historically that business looks like it's carried maybe 17% to 20% margins. Do you see getting back to that level in say 2018?

Wesley Batista

Actually we see a real scenario that this – back on 2017, not in 2018, not only corn to recover the 600 base on corn, but to adjust the export price to the level that it was a year ago is going to have the most impact in the results, because, you know again, I mentioned this before, when the real was R$3 last year, price in the international market was around $500 higher than it is, or then it was couple of months ago. But given the fact that the real went to R$4 in the end of last year, price declined because Brazil did not increase a lot volume to the export market. So, I think from now or from a month ago or couple of months ago that prices tried to pick up in the international market. So, I think the amount of time, the next five months, you put price back where the price was before. On top of that, it will normalize in the corn price is strong reimbursement have been sitting, is the year that might and can recover to the level that was before, that was last year.

Gerry Callahan

Thank you, and just quick quickly to follow-up on Jose's question. I think you mentioned 4% to 5% margins in USA Beef. Is that 2017 or 2018?

Wesley Batista

Second half of this year and 2017 is our view.

Operator

The next question comes from Bryan Hunt, Wells Fargo Securities.

Bryan Hunt

Thanks for your time. I was wondering if you could just provide a little bit more color and given the circumstances on the U.S. Beef side, and talk about maybe how July and

August is going relative to that 4 to 5% target. Are you within that arrange already for the beginning of Q3?

Wesley Batista

Yes.

Bryan Hunt

And is it the fact that the Utah startup isn't in the numbers any longer as well as the normalization of pricing in Canada? That is really driving it?

Wesley Batista

Yes. It's a combination. It's high on Canada and the better dynamic here in the U.S. market. So, growing export, so André can give you an idea. In July exports to impact how André?

André Nogueira

Our exports have touched more than 20% in July. Our export, we don't know the industry number.

Wesley Batista

Our volumes, so higher 20% higher in July compared to last year, our volume on top of that André mentioned, you know our cattle priced in Canada historically the base is – the difference, the price difference is Canada comparing to U.S. You know, you have you can see that it was much higher the price difference, U.S. was higher than Canada, and Brazil and in this first half of this year, there is spreads, but was none, so price in Canada was almost the same. Now, July and the whole part, the rest of this year, our cattle price is back to the normal level that it was historically in terms of the base in Canada. So, Canada plus higher [indiscernible] plus better dynamics is putting us enough confidence to say that we believe margins going to be and like U.S. we know our July numbers and we know where we are in the third quarter, our results and you know we are there even more.

Bryan Hunt

Switching gears and looking at our fed or your regional plants excuse me. That has Holsteins and dairy cows, and beef cows as raw material for those facilities. Dairy prices have dropped precipitously in the last year, yet there hasn't been a liquidation of dairy cows in the U.S. or at least we haven't seen the beginning of it. You know what's your

outlook for supply of animals for those regional plants?

Wesley Batista

André?

André Nogueira

You are still right, strike off the beef [ph] and the milk, we are not seeing any strong liquidation in the dairy. That's why we are just a little bit miss on this plant and still their process a little bit less cows and more Holsteins. If this changes, if we see a liquidation there, that will be very positive for this business. We are not seeing this yet. We do not anticipate this for the second part of the year. We are running with less cows that have been much less profitable in the fed and run more Holsteins. If that change, we adjust early. These plants are very well located, very well vast plant. We grew a lot in ground beef on this plant. We are in both streams and need to domestic streams. That's been great for us, and if this then to change, this will run above the normal fed business, if we have the liquditaiton there. But we're not seeing that. We are not anticipating that for the second part of the year.

Bryan Hunt

And then my last question is on value added. Part of the story, as you all continue to move your mix on order to, that's Pork or U.S. Beef, higher value added mix. Can you talk about the actions you took in Q2 to drive an increase in value added products. Thank you. That's all from me.

Wesley Batista

Nothing new. It's just the continuation of the investment that we did. Our volumes in ground beef, base red ground beef, if you compare to last year is 40% higher. Our volumes in the [indiscernible] continue to grow both in beef and pork. We will continue to invest in that. We think that's the big in the future will be a big part of our mix. And of course you have the change in the regulation, we knew that's coming out in October for the retailers in terms of the drag that they do in their back of their store. That probably will be a big bust for more tasty red ground beef.

Bryan Hunt

Thank you for your time. I'll hand it off to somebody else.

Operator

This concludes today's questions and answer session. I'd like to invite Mr. Wesley Batista to proceed with his closing statement. Please go ahead sir.

Wesley Batista

Thank you. I'd like to thank you all for being in today's call. And so thank you all for the interest on our company and looking forward to the third quarter earnings call to be with you again. Thank you. Have a good day.

Operator

This concludes today's JBS audio conference for today. Thank you very much for your participation, have a good day.